APPENDIX A

I

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 18,588

THE FARMERS BANK OF CLINTON, MISSOURI,

Appellant,

vs.

VANCE JULIAN, TRUSTEE IN BANKRUPTCY OF ROBY C. WOODY, d/b/a WOODY MOTOR COMPANY, BANKRUPT,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI

August 8, 1967

Before VOGEL, Chief Judge, GIBSON and HEANEY, Circuit Judges.

GIBSON, Circuit Judge.

This appeal concerns the Referee in Bankruptcy's orders disallowing alleged secured claims, ordering a turnover of certain alleged preferences, disallowing a bank account setoff as a preference, and subordinating appellant's secured claim to those of the general creditors of the bankrupt estate.

This appeal covers only a part of the bankruptcy administration in the Roby C. Woody bankruptcy, there being other appeals pending relative to other phases of the administration of the bankrupt estate. The District Court on Petition for Review sustained all of the Referee's findings and orders against appellant.

Roby C. Woody, d/b/a Woody Motor Company, commenced business on April 15, 1945, in Clinton, Missouri, as a franchised Cadillac and Oldsmobile dealer. He conducted the usual retail auto sales and service business of a franchised dealer, selling new and used cars, carrying a parts inventory, and maintaining service equipment necessary to operate an automobile agency. The bankrupt, Woody, utilized the financial services of the appellant, along with other banks and the large automobile financing credit institutions of GMAC, Commercial Credit Corporation and possibly C. I. T.

NOVEMBER 1957 LOAN

On November 22, 1957 Woody borrowed $16,000.00 from The Farmers Bank of Clinton, Missouri (hereafter referred to as "appellant" or "Bank"), secured by a note and chattel mortgage on "All machinery and shop equipment, Oldsmobile special tools, Cadillac special tools, furniture, fixtures, and parts bins, parts, accessories, oil and grease, and paint now owned, or hereafter purchased during the life of this loan, by Woody Motor Company,

R. C. Woody sole owner." This chattel mortgage was duly filed of record the following day. The note secured by the chattel mortgage called for payments of $1,000.00 per month plus interest, for five months with a final payment of $11,000.00 due on May 22, 1958.

The monthly payments were made as agreed but the final payment of $11,000.00 was not made as called for in the note on the due date, though the $1,000.00 monthly payments were continued until August 27, 1958, at which time there remained a balance of $7,000.00 due on the note. An oral extension of the note was made, according to the parties, with interest being paid monthly and subsequently two $500.00 payments were made, bringing the balance on the note down to $6,000.00 as of June 4, 1959.

MAY 12, 1959 LOAN

In the spring of 1959 Woody furnished the Bank with his financial statement dated March 31, 1959, which also included a Profit and Loss Statement of his operations for the first tnree months of 1959. This statement showed a net worth of $113,713.06 and a profit of $17,305.67 for the three-month period. On May 12, 1959 the Bank lent Woody an additional $12,000.00 evidenced by a note due in seven days and secured by a chattel mortgage on some automobiles. The chattel mortgage was not filed of record. Woody represented to the Bank that he needed the money for operating capital until a major loan could be obtained from Commercial Credit Corporation. The sum of $9,000.00 was repaid on this loan by June 3, 1959, leaving $3,000.00 balance due.

JUNE 3, 1959 LOAN

On June 3, 1959, Woody borrowed an additional $16,-000.00 from the Bank, $3,000.00 of which was credited to

the balance owing on the May 12 loan, discharging the May 12 loan. The remaining $13,000.00 of this loan was deposited to Woody's bank account and the loan was secured by a chattel mortgage on certain automobiles but was not filed of record. This loan was payable on demand.

An agent of the Commercial Credit Corporation was scheduled to be in Woody's place of business on about June 23, 1959 to finalize Woody's application for a major operating loan but was delayed one week in arriving. The Bank agreed to go along with Woody during this interim period. The agent of the Commercial Credit Corporation did appear on June 30, 1959 and when an officer of the Bank conferred with him and Woody at Woody's place of business, the officer found out that Commerical Credit would not make the loan until it had a detailed audit of Woody's operation. Woody and the Commercial Credit agent then requested the Bank to make a long-term loan to Woody.

At this point the officer of the Bank decided that Commercial Credit would not make the long-term operating loan. He then returned to the Bank and applied a setoff of $9,733.88 in Woody's bank account to the $16,000.00 indebtedness of June 3, 1959. On the following day, July 1, 1959, Woody gave the Bank a note and chattel mortgage on several motor cars for the remainder of the $16,000.00 indebtedness, namely $6,266.12. This chattel mortgage was filed on July 2, 1959. The cars covered under the mortgage were repossessed on either July 4 or 5, 1959, and subsequently sold for $4,850.00. A return premium on an insurance policy provided the Bank $550.00, and Jerry Woody, a third person, paid the Bank the remaining balance of $866.12—due on this indebtedness.

In addition to Woody's indebtedness to the Bank, the Commercial Credit Corporation was given a note and

chattel mortgage on July 1, 1959, recorded July 2, 1959, that covered the same property as is described in the Bank's November 22, 1957 chattel mortgage, and was made "subject to the first chattel mortgage of record" to the Bank. On July 8, 1959 the Commercial Credit filed a replevin action against the items covered by its chattel mortgage. The next day, July 9, 1959 Woody made an assignment for the benefit of creditors.

An involuntary petition in bankruptcy was filed July 13, 1959. Woody filed an answer on the same date admitting that he was insolvent, and an adjudication of bankruptcy and order of general reference was made July 14, 1959. Vance Julian was duly appointed as the Receiver and later as Trustee for the property and assets of the bankrupt.

The Trustee recovered the furniture and fixtures, the shop equipment, parts and chattels used in Woody's business from Commercial Credit. The Trustee valued these assets in his Petition for Order of Sale at $30,394.43.[1] This property was ordered sold free and clear of all incumbrances on November 5, 1959 and was actually sold on November 9, 1959 at a private sale for $23,000.00.

The Bank filed its claim as a secured creditor for the $6,000.00 together with interest at 7 percent from June 4, 1959 on the balance due on its note and chattel mortgage

---

1. "(a) Automobile parts, accessories, and supplies appraised at $19,149.05
"(b) Oil, grease, and anti-freeze appraised at 1,773.53
"(c) Office equipment appraised at 1,157.70
"(d) Shop equipment appraised at 6,292.15
"(e) Steel bins for automobile parts appraised at 2,022.00
Total ..... $30,394.43"

of November 22, 1957. The Trustee objected to the allowance of the claim and asserted in addition that the Bank had received within four months of the filing of bankruptcy void or voidable preferences and void and voidable transfers on account of antecedent and other debts while Woody was insolvent and at a time when the Bank had reasonable cause to believe that Woody was insolvent.

The Referee ruled the chattel mortgage of November 22, 1957 invalid, that the repayment of the $12,000 note of May 12, 1959 was a preference, that the repayment on the $16,000.00 note of June 3, 1959 was "a preference and/or fraudulent" (to the extent of $13,000.00) and that the Bank was not entitled to a setoff of $9,733.88 in Woody's bank account as he found the account had been "built up . . . under prearrangement". The Referee directed the Bank to turn over $25,000.00 to the Trustee and then conditioned on compliance with the turnover order allowed the Bank's claim as a subordinate and inferior claim to the rights of general creditors.[2]

---

2. In summary, there are three basic loan transactions in this dispute:

I. $16,000.00 on November 22, 1957 secured by a recorded chattel mortgage. At the time of bankruptcy, $6,000.00 remained unpaid on this loan. The Bank filed a claim asserting a secured position. The Referee found the security to be invalid and further held that the Bank's claim should be subordinated to that of the general creditors.

II. $12,000.00 on note and unrecorded chattel mortgage of May 12, 1959, which was paid down to $3,000.00 by June 3, 1959. The Referee held that the repayment of this loan constituted a preference.

III. $16,000.00 on note and unrecorded chattel mortgage of June 3, 1959.

(a) $3,000.00 was applied to the May 12 loan thus discharging that indebtedness.

(b) The $16,000.00 debt was satisfied by the Bank in the following manner:

STANDARD OF REVIEW

The Bank contends the Referee's findings and orders issued pursuant thereto and the District Court's approval of them on review were, in the respects complained of, clearly erroneous.

General Order in Bankruptcy No. 37 makes the Federal Rules of Civil Procedure applicable to bankruptcy proceedings "insofar as they are not inconsistent with the Act" and commands that these Rules "be followed as nearly as may be."[3]

Rule 52(a) Fed. R. Civ. P., states that "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." Likewise, under General Order in Bankruptcy No. 47, unless other-

---

(1) $9,733.88 was set off by the Bank on June 30, from a checking account maintained by Woody. The Referee held that this setoff was collusive and void.

(2) Chattel mortgage of July 1, 1959 under which Woody's cars were seized and sold for $4,850.00. The Referee held this security void as it was for an antecedent debt.

(3) Payment from third party sources: $550.00 from an insurance premium and $866.12 by Woody's son.

The Referee issued a turnover order covering the $12,000.00 repayment on the May 12, 1959 loan and the repayment of the $13,000.00 secured from the Bank on the June 3, 1959 loan of $16,000.00. Total turnover order of $25,000.00.

3. This Court in an opinion by Judge Blackmun in *O'Rieley* v. *Endicott-Johnson Corporation*, 297 F.2d 1 (1961), pointed out that under General Order in Bankruptcy No. 37, 11 U.S.C.A. following § 53 provides that the Federal Rules shall be followed in bankruptcy proceedings "as nearly as may be." and states at p. 4: "It has been held specifically that Rule 52(a) applies to bankruptcy proceedings. *United States Machinery Movers* v. *Beller*, 8 Cir. 1960, 280 F.2d 91, 94, cert. den. 364 U.S. 903, 81 S. Ct. 236, 5 L.Ed.2d 195; In re *Rockford Baseball Club*, 7 Cir., 1953, 201 F.2d 685, 686."

wise directed in the order of reference the Referee "shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous."

In applying and interpreting the "clearly erroneous" standard, the courts have used varying language to indicate the thrust and limitations of this principle. The Supreme Court in *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948) said: "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." This language is later quoted with approval in *Commissioner* v. *Duberstein*, 363 U.S. 278, 291 (1960).

In *Magidson* v. *Duggan*, 212 F.2d 748, 752-753 (8 Cir. 1954) cert. denied 348 U.S. 883, Judge Sanborn paraphrased the Rule as follows:

> "The findings of fact of a trial court are clearly erroneous within Rule 52 of the Federal Rules of Civil Procedure, 28 U.S.C.A., when (1) not supported by substantial evidence, (2) contrary to the clear preponderance of the evidence, or (3) based upon an erroneous view of the law. *Aetna Life Insurance Co.* v. *Kepler*, 8 Cir., 116 F.2d 1, 5; *Kasper* v. *Baron*, 8 Cir., 207 F.2d 744, 748."

In *O'Rieley* v. *Endicott-Johnson Corporation*, 297 F.2d 1, 6 (8 Cir. 1961), Judge Blackmun views the "clearly erroneous" standard as:

> "* * * that is, whether, although there is supporting evidence, 'the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed', *United States* v. *United States Gypsum Co.*, 1948, 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746; *Commissioner of Internal Revenue* v. *Duberstein*, 1960, 363 U.S. 278, 291,

80 S. Ct. 1190, 4 L. Ed. 2d 1218, or whether 'they are based upon a substantial error in the proceedings or upon a misapplication of the controlling law, or if they are unsupported by any substantial evidence, or if they are contrary to the clear weight of all the evidence'. *Kauk* v. *Anderson*, 8 Cir., 1943, 137 F.2d 331, 333. See *Pendergrass* v. *New York Life Ins. Co.*, 8 Cir., 1950, 181 F.2d 136, 138."

We now proceed to review the Referee's findings applying the "clearly erroneous" standard.

WAS THE BANK A SECURED CREDITOR UNDER THE NOTE AND MORTGAGE OF NOVEMBER 22, 1957?

The Referee found "for a period approximating two years prior to bankruptcy, * * * [the Bank] made no effort to act promptly (under the powers granted to it in said default clause) to foreclose its lien or exhaust its rights" and was passive as to its claim thereunder and "permitted the same to lie dormant for said two-year period and did nothing as to bankrupt's breaches and defaults of said prior mortgage * * *", and that the claim became inferior and subordinate to the rights of general creditors.

The undisputed facts show that this note and chattel mortgage were given for a valid consideration; that $16,000.00 was advanced and paid to Woody; that monthly payments of $1,000.00 plus interest were paid each and every month to and including August 1958, leaving a then balance of $7,000.00; that although the $11,000.00 balloon balance due in May 1958 was not paid on the due date, the note was orally extended and the $1,000.00 monthly payments were continued to and including August 1958 and the interest was paid monthly thereafter until June 4, 1959.

Under § 443.460 R. S. Mo. 1959, the chattel mortgage was a valid security instrument, the due filing thereof served as constructive notice of its provisions and it remained valid under § 443.500, R. S. Mo. 1959 for a period of five years. We are concerned only with that part of the mortgage covering the fixtures and shop equipment and not that of the movable stock of goods, such as the parts, accessories and goods held for sale to the public as an inventory stock in trade. Woody testified that the furniture and fixtures, tools and shop equipment covered under the November 1957 chattel mortgage were the same fixtures and equipment that was on hand at the time of the bankruptcy.

The Trustee has indicated that some additions or improvements might have been made on the fixtures and equipment, but there is no probative evidence to this effect. Woody testified that it was the same equipment. The Bank did testify through its officers that Woody was expanding his operation and that Woody always kept on hand up-to-date tools and equipment, but this alone is not evidence of replacement of fixed assets covered under the chattel mortgage. In addition to the enumerated items, the chattel mortgage covered "and the increase thereof."

This chattel mortgage was only nineteen months old at the time of the bankruptcy, had been paid down from $16,000.00 to $6,000.00 and was certainly not, as found by the Referee, to have been in default approximately two years. An agreement to extend the time to pay off a note secured by a mortgage does not have to be in writing. *Fisher* v. *Stevens*, 44 S.W. 769 (Mo. 1898); *Baade* v. *Cramer*, 213 S.W. 121 (Mo. 1919). An extension of a note, under Missouri law, does not destroy or in any way impair the security, which continues so long as the debt remains unpaid. *Christian* v. *Newberry*, 61 Mo. 446, 451 (1875).

Lippold v. *Held*, 58 Mo. 213, 216-217 (1874) states "the general rule is, that no mere change in mode and time of payment, nothing short of actual payment of the debt or an express release, will operate as a discharge of the mortgage. The lien lasts as long as the debt, * * *." Though *Lippold* deals with a real estate mortgage, the same principle is applicable to personal property. There is no requirement under Missouri law that a creditor foreclose his lien immediately upon default. Nor is it unlawful or sinister for a creditor to carry along a debtor. Particularly is this true when that debtor is operating a going business, utilizing other services furnished by the creditor, is expanding operations, and furnishes a balance sheet showing a net worth of over $113,000.00 and a first-quarter profit of over $17,000.00.

Trustee also contends that the Bank waived its chattel mortgage lien of November 1957 by failing to assert it against the replevin suit of Commercial Credit and later when the property was in the Trustee's possession, who subsequently sold it under Court order free and clear of liens.

There was no concealment of this lien. It was filed of record, which is notice to all. The Bank was under no legal duty to act at the time of the replevin suit as the Trustee had the right of possession, which he did obtain. The Court ordered this property sold free and clear of liens, which is the usual procedure in these type of cases and any valid lien on the chattels is transferred to the proceeds of the sale. *Coulter* v. *Blieden*, 104 F.2d 29 (8 Cir. 1939), cert den. 308 U.S. 583; *Van Huffel* v. *Harkelrode*, 284 U.S. 225 (1931).

We believe the Referee's finding and order invalidating the secured claim of $6,000.00 plus interest under the

November 22, 1957 note and chattel mortgage clearly erroneous as without any substantial evidentiary support. The claim should be allowed as a secured claim. There were sufficient assets received on the sale of the bankrupt's property covered by this chattel mortgage, exclusive of the movable stock of goods, to pay the claim in full.

SUBORDINATION OF THE BANK SECURED CLAIM ON ITS CHATTEL MORTGAGE OF NOVEMBER 22, 1957.

The Referee, in addition to denying the Bank the status of a secured creditor on its chattel mortgage claim for the balance of the note executed November 22, 1957, subordinated it to the claim of general unsecured creditors. The Supreme Court in *Pepper* v. *Litton*, 308 U.S. 295, 296, 306-7 (1939), points out that courts of bankruptcy are essentially courts of equity and in connection with the allowance and disallowance of claims, the court has the power "* * * to disallow or to subordinate such claims in the exercise of its broad equitable powers. * * * The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arms' length bargain."

Most subordination cases deal with unconscionable claims. *Pepper* revealed a scheme to defraud creditors and the subordination power is usually exercised against corporate insiders who take advantage of their position and knowledge to defraud creditors. *In re V. Loewer's Gambrinus Brewing Co.*, 74 F.Supp. 909 (S.D.N.Y. 1947) affd. 167 F.2d 318 (2 Cir. 1948), approved subordination of claims of officers, directors and stockholders that did not carry the earmarks of an arms' length bargain. *Braddy* v. *Randolph*, 352 F.2d 80 (4 Cir. 1965), was another insider case in which the corporate president's claim

and deed of trust were subordinated to claims of creditors, because of initial under-capitalization and mismanagement of the Corporation.

This Circuit in *In re Kansas City Journal-Post Co.*, 144 F.2d 791 (8 Cir. 1944), in an opinion by Judge Johnsen exhaustedly reviewed the law on bankruptcy subordination of claims. That case, at page 800 points out that while bankruptcy proceedings are a composite of law and equity jurisdiction under § 11 of Title 11, U. S. C., the court essentially, in dealing with creditors' claims, sits as a court of equity: (under *Pepper* v. *Litton*) "*but 'not without appropriate regard for rights acquired under rules of state law', Prudence Realization Corporation* v. *Geist*, 316 U.S. 89, 95"; that "Subordination is a means of regulating distribution results in bankruptcy by adjusting the order of creditors' payments to the equitable levels of their comparative claim positions;" and

> "As indicated above, its fundamental aim is to condition or to undo or to offset any inequity in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of the bankruptcy results. Its most common uses perhaps are to nullify the effect of any fraud that a creditor has committed, to prevent unjust enrichment in a fiduciary relation, and to make the transaction of officers with the corporation conform to their sound realities in the existing situation."

That case dealt with a stockholder and bondholder claim and the Referee's action of subordination against him was disapproved by both the District Court and the Court of Appeals.

This power of subordination must be soundly exercised and it should not operate to take away any rights punitively to which a creditor is justly entitled and thus give

it to other creditors who have no fair right to it. *Kansas City Journal-Post* requires either "fraud or inequity" as the proper basis for subordination. Again this Court in *Kenneally* v. *Standard Electronics Corporation*, 364 F.2d 642 (8 Cir. 1966), held that the secured claim of a creditor, which had effective control of the bankrupt corporation, should not be subordinated since there was no evidence of actual fraud or unfairness. In other words "fraud or unfairness" (unfairness is equated with inequity) is essential for a decision to subordinate.

In the case at bar we are dealing with the duly recorded security of the Bank, which had no interests in the bankrupt's operation, except as a creditor supplying the normal banking services of accounts and loans to the bankrupt. *there is absolutely no evidence of any fraud or unfair dealing.* The Bank went to lengths to aid and assist the bankrupt in his operations and should not be penalized for trying to help the bankrupt keep intact his business. No other creditors were misled or suffered any damage by reason of the Bank extending credit under the November 22, 1957 chattel mortgage. The order of the Referee subordinating this claim is clearly erroneous as being without any evidentiary basis.

THE REFEREE'S TURNOVER ORDER OF $25,000.00.

The Bank's loan of $12,000.00 to Woody on May 12, 1959 and the subsequent loan of $16,000.00 on June 3, 1959 are the subject of the Referee's turnover order. Before the June loan was obtained, $9,000.00 was repaid by the bankrupt on the May loan, with $3,000.00 of the June loan being used to pay the balance of the May advance. The Referee characterized these loans as temporary financing until Woody could obtain a long-term capital loan

from Commercial Credit Corporation or others and held that the Bank was informed of and knew of the bankrupt's financial condition.

The Referee found that the setoff by the Bank of $9,733.88 was a preference; and the Bank acting together with another bank, The First National Bank of Clinton, and in unison and jointly with the bankrupt, had "a collusive pre-arranged and planned formula of action * * * with respect to the concurrent seizure of the bankrupt's bank accounts in such banks and with respect to bankrupt's transfer of free and clear assets to each of the Banks without consideration * * *." This latter transfer by way of the July 1, 1959 chattel mortgage also constituted a preference.

The Bank contends that its advancements of $12,000.00 and $13,000.00 net by these loans were secured by the November 22, 1957 chattel mortgage. This so-called open-end chattel mortgage of November 1957 covered future advancements. However, specific chattel mortgages on cars were taken to cover these lons, and no mention was made of coverage of these transactions under the 1957 chattel mortgage. The Bank concedes that the unrecorded chattel mortgages given to secure these loans are void as to creditors and likewise concedes that if these advances were not secured by the November 1957 chattel mortgage the finding of fact that these two loans were unsecured is correct.

We think the Referee's finding on this issue is correct. There is no substantial evidence showing that these loans were to be secured by the November 1957 chattel mortgage. No mention of that mortgage was made at the time of these advances, the taking of new chattel mortgages on cars at the time of the advances and the subsequent taking of the July 1, 1959 chattel mortgage on cars to secure this in-

debtedness negatives any intention or agreement between the parties that the 1957 chattel mortgage should cover such advances. The Referee's finding that this indebtedness was not properly secured and constitutes only a general unsecured claim is clearly correct and must stand. The May and June chattel mortgages were void as to creditors because they were not filed of record and the July, 1959 chattel mortgage was a voidable preference as it was given for an antecedent debt.

Taking the loans out of order, we now consider the June 3 loan of $16,000.00 in which the Bank stands as an unsecured creditor.

WAS THE BANK ENTITLED TO OFFSET THE BANKRUPT'S ACCOUNT AGAINST THE $16,000.00 LOAN?

The Bank set off $9,733.88 on June 30, 1959 against the $16,000.00 indebtedness owed the Bank. This amount was in a general checking account used in the ordinary course of business by the bankrupt. Section 68(a)[4] of the Bankruptcy Act, 11 U. S. C. 108 applies and allows a setoff to the Bank unless the account has been accepted or built up for the real purpose of permitting the Bank to obtain a preference by way of setoff of the account. A bank account at the time of filing the petition in bankruptcy is a debt due to the bankrupt from the bank, and in the absence of fraud or collusion between the bank and the bankrupt, the bank may set the account off against any indebtedness owed it by the bankrupt. *New York County National Bank* v. *Massey,* 192 U.S. 138 (1904); *Mingus* v. *Bank of Ethel,*

4. "§ 108. Set-offs and counterclaims.

"a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

117 S.W. 683 (Mo. App. 1909); *Lebrecht* v. *New State Bank of Woodward*, 229 S.W. 285 (Mo. App. 1921); 4 Collier on Bankruptcy, § 68.16. Section 68(a) of the Bankruptcy Act did not create the right of setoff but it "recognizes this right and it cannot be taken away by construction because of the possibility that it may be abused." as it "would precipitate bankruptcy and so interfere with the course of business as to produce evils of various and farreaching consequence". *Studley* v. *Boylston National Bank*, 229 U.S. 523, 529 (1913).

The bank has the right to set off deposits against indebtedness even though the bankrupt is insolvent at the time of setoff and before the petition in bankruptcy is filed. *Fourth Nat. Bank of Wichita* v. *Smith*, 240 F. 19 (8 Cir. 1916); *In re Merchandise Mart of Columbia*, 79 F. Supp. 686 (E.D.S.C. 1948).

The Trustee has the burden of proof of proving a voidable preference by a preponderance of the evidence. *City Nat. Bank* v. *Slocum*, 272 F. 11 (6 Cir. 1921) cert. denied 257 U.S. 637; *Moran Bros., Inc.* v. *Yinger*, 323 F.2d 699 (10 Cir. 1963).

The issue is: Was the account of the bankrupt built up, with the understanding of the Bank, for the purpose of allowing the Bank to use it as an offset and thereby obtain a preference?

The Referee in his turnover order, paragraph 4, evidently considered this setoff as a preference, though he did not definitely state it to be such. However, the net effect of his turnover order of $25,000.00 would necessarily treat the setoff as a preference. The Referee's reasons were that on June 27, 1959, the bankrupt's bank balance was $34.84; on June 29, 1959 it was $10,581.15 plus an additional deposit on that same day of $762.15; and on June

30, 1959 a deposit of $480.00 was made. These deposits built up the account to $11,197.14, which build-up the Referee found to be under "pre-arrangement."

The Bank paid checks on the day of setoff totaling $1,463.26, leaving a balance of $9,733.88, which the Bank set off against Woody's indebtedness on June 30, 1959.

In addition to the evidence cited by the Referee the record shows that this account during the month of June 1959, as in prior months, was an active one. Deposits and withdrawals occurred every business day, the volume of deposits during the month totaled over $175,000.00. On five days during that month, prior to the June 29 deposit of over $10,000.00, deposits in excess of $10,000.00 were made. This account fluctuated widely and on eight days the closing balance exceeded $9,000.00 prior to June 29. The account was twice overdrawn and the account had a balance of over $12,000.00 on June 18, 1959. The average amount of deposits and withdrawals amounted to over $6,000.00. The money was usually withdrawn a short time after it was deposited as Woody was utilizing this money as fast as it became available.

After the Bank made the setoff on June 30, a number of Woody's checks that had previously been written on this account were returned because the account had been closed by the setoff. Woody testified that immediately prior to June 30, 1959 he made no effort to build up the bank account or make deposits other than to cover checks which he had written; and that the deposits were made in the usual course of business.

The Bank did not avail itself of the right of setoff until after an official of the Bank on the morning of June 30 had gone to Woody's place of business to discuss with Woody and an agent of Commerical Credit Corporation

the making of a long-term capital loan, which the Bank had been led to believe was in the offing and for which purpose an agent of Commercial Credit had made the trip to Woody's place of business. It was not until the officer of the Bank found out that Commercial Credit Corporation would not make the long-term loan that the Bank proceeded to set off the account. It was at that point that the officer of the Bank returned to the Bank and made an immediate setoff.

The Bank on that same day had already honored a number of checks totaling some $1,400.00. This evidence clearly indicates that there was no collusive build-up of the bank account and that the Bank only decided to make the setoff on the day the setoff was actually executed. The refusal of Commercial Credit to proceed with the long-term capital loan triggered the Bank's decision to avail itself of its setoff right. The pattern of deposits and withdrawals throughout the month is fairly uniform and is certainly in line with the normal business operation of the bankrupt.

The fact that checks were outstanding against the account at the time of setoff negatives any intent on Woody's part to build up the account for the purpose of setoff, and there is absolutely no evidence of any collusive or prearranged plan of action between Woody and the Bank to build up this account.

The Referee's recital of the closing balances on June 27, 1959 and June 29, 1959 might be considered as a scintilla of evidence but the clear weight of the evidence is against the finding of the Referee of a voidable preference on the setoff, and the finding giving effect to a voiding of the setoff is clearly erroneous. We have the definite and firm conviction that a mistake has been committed in not allowing the setoff to stand. Upon reinstating the setoff, it

should be applied against the unsecured indebtedness of $16,000.00 owing to the Bank.

This leaves a balance of $6,266.12 properly remaining unpaid of this unsecured $16,000.00 indebtedness. As stated earlier, the Bank attempted to satisfy this remaining indebtedness by taking a chattel mortgage on some of the bankrupt's assets on July 1, 1959 and foreclosing on the mortgage a few days later. The sum of $4,850.00 was secured on the sale of these assets. The July 1, note and mortgage were given on an antecedent debt and thus void as to the Trustee. This sum was properly ordered turned over to the Trustee.

Subsequent to bankruptcy the amount of $550.00 was received from a return of insurance premiums, and $866.12 was paid to the Bank by Jerry Woody, a son of the bankrupt, but a third party to the bankrupt's operation. These payments from third parties do not constitute a voidable transfer under § 60(a)(1) of the Bankruptcy Act as there is nothing in the record to show that these payments were made from or came out of "the property of a debtor". The Trustee in argument concedes these third party payments do not constitute a voidable preference. Thus, they were improperly made a part of the turnover order by the Referee.

In summary, of the $16,000.00 June indebtedness, $9,733.88 was properly set off by the Bank as a mutual indebtedness. The sum of $1,416.12 came from third parties subsequent to bankruptcy. Only the $4,850.00 coming from the sale of assets foreclosed under the voidable July 1 chattel mortgage may be recovered by the Trustee. For that amount the Bank must stand as an unsecured creditor.

WAS THE REPAYMENT OF THE MAY $12,000.00 LOAN A PREFERENCE?

The May loan was paid by Woody within four months of bankruptcy. On June 3, however, the sum of $3,000.00 remained unpaid. This substantial repayment of the May loan precipitated the June loan of $16,000.00. Woody received $13,000.00 in cash and $3,000.00 went to satisfy the balance of the May loan. These loans actually went to increase the bankrupt's assets and were made in the ordinary course of business to finance Woody as an operating entity.

The Referee held that the payment of the May loan was made while the Bank had "knowledge of bankrupt's insolvency or with reasonable grounds to believe that bankrupt was insolvent." The facts simply do not support this conclusion of the Referee. There is no direct evidence to show that the Bank knew or had reason to know that Woody was insolvent at the time payment was made on this loan. Woody had furnished the Bank with a financial statement dated March 31, 1959 showing a net worth of over $113,000.00 and a quarterly profit of over $17,000.00.

The fact that the Bank granted Woody a $16,000.00 loan on June 3, only a few days following the alleged preferential payments, indicates that the Bank did not believe Woody was insolvent. Obviously, had the Bank believed Woody to be insolvent they would have been extremely reluctant to extend this new credit. Even more obviously, had the Bank suspected that Woody was insolvent they would have been very careful to demand and perfect security on the additional loan. The fact that the Bank failed to perfect the security on either the May or the June loan indicates that it had confidence in Woody's financial condition and did not believe him to be insolvent when the payments were made on the May loan.

It is true the Bank knew Woody was desirous of obtaining some long-term capital financing. However, this is not unusual for any business, especially comparatively small businesses in the throes of expansion. The test for "insolvency" under § 1(19) of the Bankruptcy Act is not the inability to meet current obligations but is the state of having liabilities exceed assets. While Woody's need for capital might indicate inability to meet current obligations, it is but little evidence to support the finding that the Bank should have had knowledge that Woody had liabilities exceeding his assets. The Referee's finding that the Bank had or should have had knowledge of Woody's insolvency is contrary to the clear preponderance of the evidence, and is thus clearly erroneous under Rule 52(a).

Section 57(g) of the Act only requires the surrender of preferences declared to be voidable. Though § 60(a) generally defines a preference, § 60(b) declares to be voidable only those preferential payments made when the creditor at the time of the payment has "reasonable cause to believe the debtor is insolvent." A mere showing of a technical preference under § 60(a) is not sufficient to authorize a turnover order. *Campanella* v. *Liebowitz,* 103 F.2d 252 (3 Cir. 1939); 3 Collier on Bankruptcy, § 60.52.

Thus, as the Trustee did not carry his burden of proving that the Bank knew or had reasonable cause to believe that Woody was insolvent at the time of the payments, these preferences were not voidable under the Act and not subject to the Referee's turnover order. However, even if it could be said that the Bank had reasonable cause to believe the debtor was insolvent, we do not believe these payments could be considered preferences under § 60(a) of the Act.

The purpose of the law of preferences is to secure an equal distribution of the bankrupt's assets among his

creditors of like class. If a transaction, or series of transactions in their entirety do not interfere with this purpose it does not constitute a voidable preference. *Walker* v. *Wilkinson*, 296 Fed. 850, 852 (5 Cir. 1924), cert. denied 265 U.S. 596. There is, of course, a particular class of cases which the statute itself allows an offset against the recovery of a preference. Section 60(c) of the Bankruptcy Act provides:

> "If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him."

This is in line with the purpose of the law to require the preferred creditor to surrender only the net amount of the benefit he received in excess of that received by other creditors of his class. To the extent that § 60(c) is consistent with these primary equitable principles it should be applied. However, if exclusively applied in the case before us it does not secure an equitable distribution of the assets in accordance with the principles of the Act.

The $16,000.00 new credit was precipitated by the substantial repayment of the $12,000.00 May loan. Should we apply § 60(c) to the extent the $16,000.00 loan remains unpaid the Bank is entitled to set it off against the $12,000.00 in preferential payments. However, as the Bank exercised its right of setting off a checking account maintained in the Bank by the debtor prior to the adjudication of bankruptcy, a literal application of the section would only allow the Bank to setoff under § 60(c) the amount remaining unpaid after the setoff of these mutual debts as probided in § 68(a). As $9,733.88 was set off from the

debtor's account in the Bank, only $6,266.12 actually remained unpaid on the $16,000.00 new credit. Thus, under § 60(c) only $6,266.12 could be set off against the repayment of the $12,000.00 May loan.

This application of § 60(c) results in incomplete relief and consequently in an inequitable distribution of the bankrupt's assets. Had not appellant extended the additional credit, it would stand as an unsecured creditor in the amount of the $12,000.00 May loan, retaining its right of setoff on its debt arising from the checking account. Because of the additional credit appellant stands as an unsecured creditor on $16,000.00. In addition, by the application of § 60(c) appellant must turn over and stand as an unsecured creditor on the $6,266.12 which may not be set off on the preferential repayment of the May 12 loan. Thus the Bank is penalized for the extension of the new credit.

Furthermore, had the Bank waited until after adjudication of bankruptcy to claim its setoff arising from mutual debts, it would have been allowed a full setoff under § 60(c). As appellant had a right under the Act to exercise this mutual debt setoff prior to bankruptcy it is inequitable to penalize the Bank when it so acts by denying it full setoff rights on the new credit. Yet a literal application of § 60(c) results in just such a penalty.

However, §60(c) is not the exclusive remedy governing the offset of credits. *Walker* v. *Wilkinson*, supra. Primary reference should be made to the purposes of the Act to determine if the transactions would interfere with equal distribution of assets among the creditors of a like class. In so holding the court in *Gans* v. *Ellison*, 114 F. 734, 737 (3 Cir. 1902) stated:

> "The net balance in favor of the creditor is the real preference under the law. For only to the extent

> of such net gain does the creditor 'obtain a greater percentage of his debt than any other creditors of the same class.' And so, on the other hand, only to the amount of the net gain to the creditor is the estate of the debtor impaired."

In *Kimball* v. *E. A. Rosenham Co.*, 114 F. 85, 88 (8 Cir. 1902) this Court held:

> "Our conclusion is that the receipt by a creditor of payments upon an account current, in the usual course of business, which are followed by new credits for property delivered to the debtor, which become part of his estate, for which the creditor has not been paid, and which equals or exceeds in amount and in value the payments, does not constitute a preference, under section § 60(a) ** * *."

We recognize that these cases fall into a general "running account rule" which has been widely recognized in bankruptcy law. See, 3 Collier on Bankruptcy, § 57.19 [4.1]. *Atlas* v. *Eastern Yarn Mills, Inc.*, 27 F.Supp. 478 (E.D. N.Y. 1939). Though the facts in the case before us do not show a "running account" we believe the equitable principles that would govern that class of cases are equally applicable to the case before us.

When a creditor in good faith enriches a debtor's estate and this enrichment was caused by the otherwise preferential payment of an outstanding debt, the other creditors are only treated inequally to the extent that the preferential payments exceeded the new advances. If the new credit equals or exceeds the amount of the otherwise preferential payment the other creditors have not been harmed. Consequently, there is no recognizable preference under the equitable principles of § 60(a). How can it be said that one creditor is preferred over the others when immediately upon payment of a $12,000.00 loan the creditor gives the debtor an additional $16,000.00 in credits and

assets? The net result of such a transaction is to enrich the estate of the bankrupt a total of $4,000.00.

Thus, after the alleged preferential payment followed by a new loan the creditors of the bankrupt had $4,000.00 more toward the satisfaction of their claims. Therefore, we cannot see how this transaction of payment followed by new credit of equal or greater amount can be classed as a preference to the Bank. Viewing the transaction as a whole (*Schreiber* v. *Colt*, 80 F.2d 511 (10 Cir. 1935); *Walker* v. *Wilkinson*, supra), not only are the other creditors actually benefited, but the Bank received no greater share of the bankrupt's assets than it would had the bankrupt failed to satisfy the May loan.

As these transactions do not interfere with an equal distribution of the bankrupt's assets among creditors of appellant's class, we believe the repayment of the $12,000.00 May loan did not result in a preference to the Bank as it precipitated new assets flowing to the bankrupt in excess of the amount of the payments. *Wertz* v. *National City Bank of Evansville*, 115 F.2d 65 (7 Cir. 1940), cert. denied 311 U.S. 675; *Gans* v. *Ellison*, supra; *Kimball* v. *E. A. Rosenham Co.*, supra; *Atlas* v. *Eastern Yarn Mills, Inc.*, supra.

SUMMARY

In a recapitulation of this sad episode in the affairs of the bankrupt we are of the opinion that the balance due the Bank on the November, 1957 loan is validly secured by the recorded chattel mortgage of that date and thus constitutes a secured claim. Payment of the May 1959 loan was not a preference in that the payment secured additional assets to the bankrupt. A balance of $4,850.00 is subject to the Referee's turnover order.

As of June 3, 1959, after the repayment of the May, 1959, indebtedness, Woody was indebted to the Bank in the amount of $16,000.00, exclusive of the debt secured by the chattel mortgage of November, 1957. The chattel mortgage given to secure this $16,000.00 was void as to third parties, it not having been recorded as required under the Missouri law. The subsequent chattel mortgage of July 1, 1959 was void as to third parties, which includes the Trustee, as it was given for an antecedent debt. This leaves the Bank in the position of having a $16,000.00 unsecured debt at the time the setoff from Woody's general checking account in the amount of $9,733.88 was made, thus leaving a balance of $6,266.12 properly remaining unpaid of this unsecured indebtedness.

Subsequent to the bankruptcy, the amounts of $550.00 and $866.12 were received from third parties to the bankrupt's operation, and were properly applied to the unsecured indebtedness of the Bank, thus leaving the Bank with an unsecured indebtedness of $4,850.00. This indebtedness was satisfied by the Bank's foreclosure of the voidable July 1 mortgage, and as such, may be recovered by the Trustee.

The Trustee, in addition to asking the Court to sustain all of the Referee's turnover order, asked that the Referee's order be modified to include as a part of that order and in addition thereto an order on the Bank to return the $9,733.88 which it set off from the bankrupt's account. We need no further discussion on this matter for two reasons: 1) the setoff was proper; and 2) this modification would obviously call upon the Bank to return double the amount it actually received in the setoff since the setoff was already ordered repaid by the inclusion in the accounting on the $25,000.00 turnover.

The judgment below is reversed and remanded with instructions to modify the turnover order to find as a preference the payment of $4,850.00 received by the Bank in payment of its unsecured indebtedness, which amount remains an unsecured claim against the bankrupt, subject to allowance upon compliance with the turnover provisions of § 57(g) of the Bankruptcy Act, 11 U.S.C. § 93.

Judgment reversed in part, modified and remanded for further proceedings consistent with this opinion.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

II

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI, WESTERN DIVISION

IN THE MATTER OF ROBY C. WOODY, d/b/a WOODY MOTOR COMPANY, Bankrupt. } **In Bankruptcy No. 23807**

Petitions for Review of:

I. Various Claimants.

II. First National Bank of Clinton, Mo.

III. The Farmers Bank of Clinton, Mo.

IV. Commercial Credit Corporation.

(District Court's) Memorandum Opinion and Decision on Four Petitions for Review

(Filed January 5, 1966)

Four petitions for review pend in this case. Each petition for review is separate from the others although all relate to orders entered in the same bankruptcy proceeding. Separate judgments on our decisions in regard to each petition for review will be entered in accordance with Rule 58 of the Rules of Civil Procedure.

In connection with all four petitions and before detailed study of the various petitions for review, we made inquiry of counsel as to whether any party wished, pursuant to the

authorization of General Order in Bankruptcy No. 47, to adduce any further evidence or to have any further hearing in connection with any of the four petitions for review.

Counsel for all parties advised us that no further hearing was desired by any party and that all parties wished to have each petition for review submitted on the stipulations, evidence, and briefs filed before the Referee as supplemented by briefs filed in this Court.

Three of the petitions for review will be decided on the merits; the fourth must be recommitted to the Referee with instructions for reasons that we shall state in detail in part IV of this memorandum opinion.

I.

Petition for Review Filed by Various Claimants

Most of the facts involved in this petition for review were stipulated. Additional testimony was heard by the Referee. On the basis of all the evidence the Referee made a specific finding that:

> 1. The above named claimants (hereinafter called joint-owners), except as herein otherwise found, are not creditors of the bankrupt but at all times mentioned here are and were joint-venturers and investors in bankrupt's business as participants in a joint enterprise with bankrupt and have no allowable claim as creditors in this estate and have no right of set-off.

Additional findings concerning the history of each claimant's involvement with the bankrupt were detailed and in paragraph 5 of his order the Referee found and held that:

> 5. A summary of the transactions between the bankrupt and said joint-owners under the "Automobile Purchase Agreement" is that (in addition to the afore-

said payments in money and participation rights) bankrupt agreed to "sell" each joint-owner a new automobile each year in exchange for his old car, for which the joint-owner was to pay bankrupt only the sum of $1.00 over and above the trade-in value of the old car, plus an additional sum to cover the cost of transfer, extra equipment furnished the new car or extra charge for change in car model, but nothing more.

These car transactions were pretended sales for a pretended purchase price which were calculated to, and did, result in bankrupt suffering substantial losses to the detriment of creditors. The exchange of an old car for a new automobile each year for the sum of $1.00 resulted in the joint-owner getting a new car or cars each year for less than the actual factory cost of the new automobile. The losses sustained thereby benefited the joint-owners and depleted bankrupt's assets in fraud of the rights of general creditors. These car exchanges were fraudulent and void preferences, obligations, transfers and conveyances by bankrupt while insolvent to persons interested in bankrupt's business as joint-owners therein when such persons knew or had reasonable cause to know that bankrupt's business was insolvent. By the aforesaid transactions, said joint-owners abstracted, transferred and conveyed to themselves and away from the general creditors bankrupt's money and property and thereby depleted bankrupt's assets and estate for their personal benefit at the expense of the creditors. Said losses are set forth in the separate finding made, infra, with respect to each separate claim.

The claims of the petitioners for review were disallowed and each claimant, or his successor in interest, was ordered to turn over the moneys paid each during bankrupt's stipulated insolvency and each was required to reimburse the estate for the amount of the loss suffered by the bankrupt on the various car trades involved. Such

order either wiped out or subordinated the entire claims of all claimants.

The first question presented in the Referee's certificate is stated as follows:

> 1. Whether such claimants are not creditors of bankrupt but at all times shown by the evidence and as found by the Referee are and were joint-venturers and investors in bankrupt's business as participants in a joint enterprise with bankrupt, and thus have no allowable claims as creditors and have no right of set-off.

That question, as do the other two questions involved in this petition for review that need not be quoted, obviously involves a question of fact.

In *In re Cox*, W.D. Mo. 1965, 244 F. Supp. 430 at 433, we set forth at length our duties as a reviewing court under General Order in Bankruptcy No. 47. We here incorporate what we said there by this reference.

We believe, however, that a word should be added to what we said in *In re Cox* because it has been suggested in some of the briefs filed in this case that inferences drawn by the Referee from stipulated or undisputed facts are not within the scope of the clearly erroneous rule. What we shall say in addition to what we said in *In re Cox* is applicable to all of the petitions for review now before us and shall be so considered by all parties.

In *In re Cox* attention was directed primarily to the standard and scope of our review of findings of fact made by a Referee in Bankruptcy. We there noted that "both Rule 52 (a) of the Rules of Civil Procedure and General Order No. 47 contain the same 'clearly erroneous' standard" (244 F. Supp. at 434). We added that the "standard of review" to be applied by the District Court in its deter-

mination of whether the findings of fact of a Referee are "clearly erroneous" is the same "standard of review [as] that provided by the same 'clearly erroneous' language of Rule 52 (a) as explained by the Supreme Court cases to which we have referred" (244 F. Supp. at 435).

In *In re Cox*, among other Supreme Court cases, we directed attention to *United States* v. *Gypsum Co.*, 333 U.S. 364 at 395 (1948), and to *Commissioner of Internal Revenue* v. *Duberstein*, 363 U.S. 278 at 291 (1960). We did not quote in *In re Cox* what the Supreme Court said in those cases about inferences being within the "clearly erroneous" standard of review. We now quote the teaching of those cases in order that our view of the standard that must be applied by a District Court to inferences drawn by a Referee in his findings of fact be in the books.

Both *Gypsum Co.* and *Duberstein* expressly held that the clearly erroneous standard was applicable to and included inferences drawn from the facts as found by the trier of the facts. *Gypsum* held that "in so far as this finding and others . . . are inferences drawn from documents or undisputed facts . . . Rule 52 (a) of the Rules of Civil Procedure is applicable" (333 U.S. at 394).

And *Duberstein* held that "the rule applies . . . to factual inferences from undisputed basic facts . . . as will on many occasions be presented in this area" (363 U.S. at 291).

We think it obvious that if the identical "clearly erroneous" standard of review language in General Order in Bankruptcy No. 47 is read more narrowly than the "clearly erroneous" standard of review language in Rule 52 (a) of the Rules of Civil Procedure a District Court would be required to make a *de novo* review of all orders of a Referee

that are based on inferences drawn by him from stipulated or undisputed factual situations.

We held by implication in *In re Cox* that such was not the purpose or intent of General Order in Bankruptcy No. 47.

We now make clear by adding to what we implied but did not expressly state in *In re Cox* that we believe that a District Court is required by General Order in Bankruptcy No. 47 to accept all factual inferences that a Referee may make in a particular case from stipulated or undisputed basic facts unless such inferences are found to be "clearly erroneous". We further believe that the meaning to be given the "clearly erroneous" standard of review language is that stated in the cases construing both General Order in Bankruptcy No. 47 and Rule 52 (a) of the Rules of Civil Procedure to which we have referred in this case and in *In re Cox.*

What we have here added to what we said in *In re Cox* is, of course, applicable to all the petitions for review that are now before us and shall be so considerered by the parties.

Our examination of the evidence in connection with the Various Claimants' petition for review convinces us that the Referee's findings of fact and the inferences drawn from those are supported by substantial evidence and that we cannot say on that record that such findings are "clearly erroneous" within the meaning of General Order in Bankruptcy No. 47. We further determine that the Referee correctly applied the law to the facts as he found them. See and compare the rationale of *Pepper v. Litton*, 308 U.S. 295 at 303, et seq. (1939).

Accordingly, the order of the Referee of May 28, 1964, the subject of the Various Claimants' petition for review,

should be and is hereby adopted and confirmed. The Clerk shall enter a separate judgment in accordance with Rule 58 of the Rules of Civil Procedure.

II.

Petition for Review Filed by First National Bank of Clinton, Missouri

Most of the facts were stipulated in regard to this petition for review. Additional testimony was received at a hearing. On the basis of the evidence the Referee made special and detailed findings of fact concerning a Reserve Account established by bankrupt at the claimant bank; concerning thirteen chattel mortgages given claimant on used cars owned by bankrupt; concerning other actions taken by bankrupt in regard to other creditors, which the Referee found to sustain the existence of a pre-arrangement between claimant and such other creditors together with the bankrupt in regard to all the transactions taken by each that occurred shortly before bankruptcy, all of which the Referee found to have been done in concert and in disregard of the rights of general creditors; and concerning claimants' action in regard to one car covered by claimant's floor plan mortgage that it permitted GMAC to pick up and keep.

The Referee, on the basis of his detailed findings of fact, concluded that:

> That under the evidence and these findings, claimant received illegal, void, voidable and fraudulent preferences, liens, conveyances, transfers, assignments and encumbrances of bankrupt's money and property totalling $10,630.89, in fraud of creditors, as hereinafter detailed, for antecedent debts, within four months prior to bankruptcy, with knowledge of bankrupt's insolvency or with reasonable grounds to believe that bankrupt was insolvent, knowing that it was being or

would be preferred thereby and that thereby bankrupt was or would be rendered unable to continue in business in violation of Sections 60 and 67 of the Bankruptcy Act (11 USCA, Secs. 96 and 107), to-wit:

(a) Claimant's unlawful set-off of its floor-plan obligations against bankrupt's "Reserve Account", a special purpose account, in the sum of $2,625.89;

(b) Money received by claimant from the sale of 11 cars which it repossessed at night as stated supra, and which it sold for $6,790.00;

(c) The loan value of the car floor-planned with claimant which claimant voluntarily allowed GMAC to pick up and keep under an inferior chattel mortgage in the sum of $1,215.00;

That the premises considered, it is hereby:

ORDERED AND ADJUDGED: That First National Bank of Clinton be and it is hereby ordered and directed to turn over, surrender and pay to Vance Julian, Trustee herein, the sum of $10,630.89.

The petition for review attacks the findings of fact made by the Referee as being unsupported by the evidence and contrary to the evidence submitted by claimant.

As in the case of first petition for review discussed above, we have reviewed the evidence adduced in connection with the turn-over proceeding against the First National Bank of Clinton in accordance with the command of General Order in Bankruptcy No. 47.

The fact that the briefs filed with this Court in connection with this particular petition for review do not cite a single case (claimants did cite Section 303 of 9 C.J.S. Banks and Banking on page 7 of its brief) indicates that claimants' arguments are factual rather than legal.

We are convinced that the Referee's findings of fact and the inferences he made from those facts are supported by substantial evidence. It therefore cannot be fairly said that such findings are "clearly erroneous" within the meaning of General Order in Bankruptcy No. 47. We further determine that the applicable law was correctly applied by the Referee.

Accordingly, the Referee's order of June 10, 1964 relating to the First National Bank of Clinton should be and is hereby adopted and confirmed. The Clerk shall enter a separate judgment in accordance with Rule 58 of the Rules of Civil Procedure.

III.

Petition for Review Filed by The Farmers Bank of Clinton, Missouri

The pattern of the petition for review filed by The Farmers Bank of Clinton is generally the same as that filed by the First National Bank of Clinton. Based on a lengthy stipulation and upon oral testimony the Referee made detailed findings of fact from which he concluded that:

> That under the evidence and the foregoing findings claimant received void, voidable and fraudulent preferences, liens, conveyances, transfers, assignments and encumbrances from the bankrupt totalling $25,000.00 as hereinafter set forth for antecedent debts, within four months prior to bankruptcy, with knowledge of bankrupt's insolvency or with reasonable grounds to believe that bankrupt was insolvent, knowing that it was being or would be preferred thereby, to-wit:
>
> (a) The $12,000.00 May, 1959, loan held by claimant as a general unsecured creditor on which bankrupt paid claimant the sum of $9,000.00;

(b) The $16,000.00 June, 1959, loan held by claimant as a general creditor which bankrupt paid to claimant in full by the transfer of money and property as aforesaid, the sum of $16,000.00—total $25,000.00; that after consideration of all the evidence presented and upon the aforesaid findings, it is hereby

ORDERED AND ADJUDGED:

That Farmers Bank of Clinton be and it is hereby ordered and directed to turn-over, surrender and pay to Vance Julian, Trustee herein, the sum of $25,000.00;

That upon complying with said order pursuant to Section 57 of the Bankruptcy Act (11 U.S.C.A. Sec. 93), the claim of said Farmers Bank of Clinton be and the same is hereby allowed, subject, subordinated and inferior to the rights of general creditors of this estate; and

That if said Farmers Bank of Clinton does not comply with the aforesaid order to pay said $25,000.00, then the claim of said Farmers Bank of Clinton be and the same is hereby disallowed.

We have studied the record and the cases cited by both parties. We are convinced that the findings of fact and inferences made and drawn by the Referee are supported by substantial evidence and that such findings cannot be said to be "clearly erroneous" within the meaning of General Order in Bankruptcy No. 47. We are of the opinion that the Referee correctly applied the law.

Accordingly, the Referee's order of June 10, 1964, relating to the Farmers Bank of Clinton should be and is hereby adopted and confirmed. The Clerk shall enter a separate judgment in accordance with Rule 58 of the Rules of Civil Procedure.

IV.

Petition for Review Filed by Commercial Credit Corporation

An entirely different situation exists in regard to the petition for review filed by Commercial Credit Corporation.

The Referee did not follow the same procedure in connection with his orders of May 28, 1964 that are the subject of that petition for review as he followed in connection with the orders involved in three other petitions for review here involved.

The Referee did not make any findings of fact before he entered the orders involved in Commercial Credit Corporation's petition for review until after those orders had been entered. The Referee's failure to comply with General Order in Bankruptcy No. 47 and with Rule 52 (a) of the Rules of Civil Procedure, made applicable to bankruptcy proceedings by General Order in Bankruptcy No. 37, requires that the matters involved in Commercial Credit Corporation's petition for review be recommitted to the Referee with instructions for the reasons we shall now state.

In *In re Cox, supra,* we discussed but one facet of General Order in Bankruptcy No. 47. The procedures followed by the Referee in connection with the two orders involved in Commercial Credit Corporation's petition for review require that we discuss another facet of that General Order in Bankruptcy and the applicability of Rule 52 (a) of the Rules of Civil Procedure to bankruptcy proceedings by virtue of General Order in Bankruptcy No. 37.

We start, of course, from the factual base that the order of reference of the present bankruptcy proceeding did not contain any special or general direction that the Referee

should not set forth his findings of fact and conclusions of law. General Order in Bankruptcy No. 47 authorizes such an order but no such order was entered in this case.

The Referee's "Order on Trustee's Amended Objections to Allowance of Commercial Credit Corporation's claim and the Trustee's Second Amended Petition for Order to Show Cause," the first order subjected to Commercial Credit Corporation's petition for review, stated:

> The Commercial Credit Corporation's Proof of Claim and Alternative Proof of Claim, the Trustee's Amended Objections thereto, the Trustee's Second Amended Petition for Order to Show Cause, and the Order to Show Cause directed to Commercial Credit Corporation made pursuant thereto, and the Commercial Credit Corporation's Answer to said Order came on for hearing on February 27, 1964; Vance Julian Trustee herein, appearing in person and by his attorneys Phineas Rosenberg and Barkley M. Brock, and Commercial Credit Corporation appearing by T. Bailey Mourning, its Area Manager, and Charles F. Lamkin, Jr., its attorney, and the aforesaid proceedings having been submitted by the parties hereto on Stipulation of Facts and by oral testimony, and the court having duly considered the submission made and being fully advised, does hereby find:
>
> 1. That between July 1 and July 13, 1959, and within four months prior to bankruptcy, Commercial Credit Corporation received void, voidable and fraudulent preferences, liens, conveyances, transfers, assignments and encumbrances from bankrupt totaling $26,538.61 for an antecedent debt with knowledge of bankrupt's insolvency and that it was being preferred thereby, consisting of the following:
>
> (a) Daniel H. and Mary Lou Anderson note for $425.00 dated June 29, 1959, secured by chattel mortgage on 1956 Oldsmobile numbered 568K13621;

(b) John K. Pate retail sales contract for $2,970.00 dated June 29, 1959, for 1959 Oldsmobile numbered 597K16968;

(c) Ernie A. Fisher retail sales contract for $3,385.00 dated June 29, 1959, for 1959 Oldsmobile numbered 599K06739;

(d) Applying bankrupt's reserve account totaling $9,397.00 to its antecedent debt to which Commercial Credit Corporation had no right, title or interest under the "Retail Finance and Reserve Agreement" as against the creditors of this estate;

(e) Oscar Polzin retail sales contract for $4,296.37 dated July 2, 1959 for 1959 Oldsmobile numbered 597K15360;

(f) J. B. Hall retail sales contract for $5,118.01 dated July 3, 1959;

(g) James Floyd Postlethwait retail sales contract for $737.16; and

(h) The credit of $210.07 applied by it against bankrupt's shortage to Commercial Credit Corporation arising on July 7, 1959, as an excess in the transaction involving the sale of 1959 Cadillac numbered 59K104330;

2. That on July 8, 1959 (within four months prior to bankruptcy) Commercial Credit Corporation received and acquired from bankrupt by replevin proceedings void, voidable and fraudulent preferences, liens, conveyances, transfers, assignments and encumbrances consisting of 28 new and used automobiles, specifically listed in the evidence presented here, which Commercial Credit Corporation sold for $73,786.51; that Commercial Credit Corporation received the same on an antecedent debt when it knew that the bankrupt was insolvent and that it was being preferred thereby.

3. That no part of the aforesaid sums of $26,538.61 and said $73,786.51 so obtained and received by Commercial Credit Corporation, as aforesaid, has been turned over or surrendered to the Trustee herein; that unless and until Commercial Credit Corporation turns over or surrenders such sums to the Trustee pursuant to and in compliance with the provisions and requirements of Section 57 of the Bankruptcy Act (11 USCA, Sec. 93), the aforementioned claims of Commercial Credit Corporation should be and stand disallowed but upon the turn-over and surrender thereof in compliance with said Section 57, Commercial Credit Corporation may present its then existing claim to this court for consideration and allowance. It is accordingly

ORDERED AND ADJUDGED: That Commercial Credit Corporation be and it is hereby ordered and directed to turn over, surrender and pay to Vance Julian, Trustee herein, the aforesaid sums totalling $100,325.12; and that upon said Commercial Credit Corporation complying therewith, as hereby ordered, said Commercial Credit Corporation may file and present its then existing claim to this court for consideration and allowance, otherwise the aforementioned claims heretofore filed herein be and the same are hereby disallowed.

The Referee's "Order on Commercial Credit Corporation's Motion to Vacate Order entered December 11, 1963", the second order subjected to Commercial Credit Corporation's petition for review, stated:

The Motion To Vacate Order filed herein by Commercial Credit Corporation directed to this court's Order Approving Compromise made in this cause on December 11, 1963, having been duly considered, it is hereby

ORDERED that the aforesaid Motion to Vacate Order be and the same is hereby denied and that

this court's Order Approving Compromise be and the same is and shall remain in full force and effect as entered on December 11, 1963.

After holding some sort of a hearing subsequent to the entry of those two orders, but before the petition for review was filed, the Referee prepared and filed his certificate on Commercial Credit Corporation's petition for review, as required by Section 39(a) (8) of the Bankruptcy Act (11 U.S.C.A. 867 (a) (8)). That section provides that:

> 39. *Duties of Referees.* a. Referees shall . . . (8) prepare promptly and transmit to the clerks certificates on petitions for review of orders made by them, together with a statement of the questions presented, the findings and orders thereon, the petition for review, a transcript of the evidence or a summary thereof, and all exhibits.

After a statement of five questions presented by the petition for review, the Referee's Certificate contained a fourteen page section entitled "Evidence and Findings Thereon."

The data contained in that section of the Referee's Certificate cannot be said to be the findings of fact required of a Referee by General Order in Bankruptcy No. 47 and Rule 52 (a) of the Rules of Civil Procedure. The section of the certificate entitled "Evidence and Findings thereon" was not written until long after the order of May 28, 1964 had been entered.

Nor can that section of the Referee's certificate be said to be a "summary [of the] transcript of the evidence" within the meaning of Section 39 (a) (8) because, on its face, it purports to make findings of fact and to state conclusions of law in regard to the two orders entered some four months earlier.

On page 10 of the Trustee's brief it is stated: "In the Referee's aforementioned order dated May 28, 1964, and in the Referee's Certificate On Petition For Review Filed by C.C.C., the Referee carefully detailed and digested the pleadings, the issues, the oral evidence, the stipulated and admitted facts and then made his findings of fact which he supported with record references." (p. 10 Trustee's brief).

As is apparent from the Referee's orders of May 28, 1964, which we have set forth in full, the Referee did not detail and digest the pleadings, issues, the oral evidence, the stipulated and admitted facts in those orders. Nor did he make in those orders anything other than findings of ultimate facts in highly conclusory language.

In recognition of the necessity to legitimate the findings of fact the Referee attempted to make in his certificate above, the Trustee suggests, again on page 10 of his brief, that:

> Both the order now under review and the Referee's said certificate are to be considered. See *In re D.I.A. Sales Corporation,* 339 F. 2d 175, l. c. 180, par. 7. (CA-6).

We do not believe that suggestion is tenable. We recognize, of course, that *In re D.I.A. Sales Corporation,* without the citation of any authority, apparently holds that:

> We find no merit in appellant's contention that the order of the referee was defective in that it failed to set forth his findings of fact and conclusions of law. In the first footnote we have quoted from the findings of fact and conclusions of law contained in the referee's certificate on the petition for review. We hold that the certificate of the referee contained adequate findings of fact and conclusions of law and that it was not

necessary for him to set forth these same findings and conclusions in the order. (339 F. 2d 180).[1]

If *In re D.I.A. Sales Corporation* and *In re Berman & Company* represent the considered rule of decision in the Sixth Circuit, we must respectfully refuse to follow those cases. Whatever may be the rule in the Sixth Circuit we are convinced that the settled rule of decision in the Eighth Circuit requires that the matters involved in the Commercial Credit Corporation's petition for review be recommitted to the Referee with instructions that he comply with the requirements of General Order in Bankruptcy No. 47 and Rule 52 (a) of the Rules of Civil Procedure. We now state our reasons.

General Order in Bankruptcy No. 47 provides:

> Unless otherwise directed in the order of reference the report of a referee . . . shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.

Any question as to whether a Referee is required to "set forth his findings of fact and conclusions of law" in connection with orders other than a special report under a special reference[2] is removed by General Order in Bank-

---

1. See also *In re Berman & Company*, 6 Cir. 1965, 343 F. 2d 125, at 126, where, apparently, and again without the citation of any authority, the Sixth Circuit approved the inclusion of findings of fact and conclusions of law in a referee's certificate. *In re D.I.A. Sales Corporation* was cited in that case, in connection, however, with another proposition.

2. See the first full paragraph in the second column of Referee Heisey's Comment in 35 Journal of the National Association of Referees in Bankruptcy, p. 39 (April, 1961), to which Judge

ruptcy No. 37 and Rule 52 (a) of the Rules of Civil Procedure. The former provides:

> In proceedings under the Act the Rules of Civil Procedure for the District Courts of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. But the court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation or hearing of any particular proceeding.

And Rule 52 (a) consistently provides in part that:

> In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; . . . Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . . If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein.

The Eighth Circuit recognized at an early date that "the referee, unless otherwise directed, 'shall set forth his findings of fact and conclusions of law'." *Arkansas Oil & Mining Co.* v. *Murray Tool & Supply Co.*, 8 Cir. 1942, 127 F. 2d 564 at 566. See also *Troutwein* v. *Mandel*, 8 Cir. 1942, 127 F. 2d 567 at 569, where it was recognized that under

---

Blackmun directed attention in footnote 1 on page 4 of his opinion in *O'Reiley* v. *Endicott-Johnson Corporation*, 8 Cir. 1961, 297 F. 2d 1, where some question is raised. We agree with much of what Referee Heisey stated in his comment concerning the Eighth Circuit rule except for the paragraph noted. We believe, however, that the applicability of Rule 52 (a) makes the point raised in the cited paragraph a moot question.

General Order in Bankruptcy No. 47, "there must be findings of fact and conclusions of law made by the referee and covering the essential issues."

In *U. S. Machinery Movers* v. *Beller*, 8 Cir. 1960, 280 F. 2d 91 at 94, the Eighth Circuit expressly held that "Rule 52 (a) of the Federal Rules of Civil Procedure, 28 U.S.C.A., (which, by virtue of General Order in Bankruptcy 37, is applicable to proceedings under the Bankruptcy Act) requires that the court shall find the facts specially and state its conclusions of law thereon." Of course, the word "court" in that quotation refers to the Referee. Under a general reference, the Referee, by definition, acts as a court; not as some sort of special master. See Section 1(9) of the Bankruptcy Act (11 U.S.C.A. § 1 (9)) which provides that "'court' shall mean the judge or the referee of court of bankruptcy in which the proceedings are pending."

The late Judge Sanborn further stated in *U. S. Machinery Movers* that:

> Our understanding is that a district judge called upon to review a referee's order, is entitled to have from the referee an adequate and accurate statement of the facts and the law upon which he relied in making his order. It is also our understanding that, when an appeal is taken from an order such as that here involved, this Court must have a record which discloses the exact factual and legal basis for the order under review. See and compare, *In re Rockford Baseball Club, Inc.*, 7 Cir. 201 F. 2d 685; *In re Cesari*, 7 Cir. 217 F. 2d 424, 427-428.

In re Rockford Baseball Club, 7 Cir. 1953, 201 F. 2d 685, cited with approval by the Eighth Circuit in *U. S. Machinery Movers*, involved a case in which the referee made no specific findings of fact. After holding that Rule 52 (a)

was made applicable to bankruptcy proceedings by General Order in Bankruptcy No. 47, that case held at page 686:

> This court has many times held that a fair compliance with Rule 52 (a) is mandatory. While findings in elaborate detail are neither required nor desirable, "They should be so explicit as to give the reviewing court a clear understanding of the basis of the trial court's decision * * * and to enable it to determine the ground upon which the trial court reached its conclusion." *Maher* v. *Hendrickson*, 7 Cir., 188 F. 2d 700, 702.

In re Rockford Baseball Club emphasized that the making of ultimate findings of fact without also making supporting subsidiary findings of fact is meaningless and that the making of ultimate findings alone does not comply either with General Order in Bankruptcy No. 47 or with Rule 52 (a) of the Rules of Civil Procedure.

The court held that what the Supreme Court said concerning the duties of a District Court in regard to making findings of fact is applicable to the findings that must be made by a Referee. Quoting from *Kelly* v. *Everglades Drainage District*, 319 U.S. 415 (1943) at 421-22, that court held at page 687:

> It is not the function of this [reviewing] court to search the record and analyze the evidence in order to supply findings which the trial court [referee] failed to make. * * * the nature of the evidentiary findings sufficient and appropriate to support the court's [referee's] decision * * * is for the trial court [referee] to determine in the first instance in the light of the circumstances of the particular case. We hold only that there must be findings * * * which are sufficient to indicate the factual basis for the ultimate conclusion. (Brackets ours).

The appropriate action to be taken by a District Court in a case in which the Referee fails to comply with General Order No. 47 and Rule 52 (a) was stated as follows:

> The order of the District Court is reversed and the cause remanded, with directions that the cause be remanded to the referee in bankruptcy with instructions that the referee make appropriate findings of fact, in conformity with this opinion, and then state his conclusions of law thereon.

See also *In re Cesari*, 7 Cir. 1954, 217 F. 2d 424, the second case cited with approval by the Eighth Circuit in *U. S. Machinery Movers*, in which the cause was reversed and remanded to the District Court with instructions to remand to the Referee in order that his failure to make both ultimate and subsidiary findings be corrected. And see *O'Rieley* v. *Endicott-Johnson Corporation*, 8 Cir. 1961, 297 F. 2d 1, in which the Eighth Circuit reiterated that "it has been held specifically that Rule 52 (a) applies to bankruptcy proceedings," cited and relying on both *U. S. Machinery Movers* and *In re Rockford Baseball Club*.

The decision in *Endicott-Johnson Corporation* underlines the paramount importance of a referee's findings of fact. That case resolved any doubt that may have existed "that in this circuit the clearly erroneous standard is to be applied to the referee's findings and not to those of the district court." See also and compare *Standard Electronics Corporation* v. *Kenneally*, 8 Cir. 1964, 336 F. 2d 394 at 396. The prime importance of a referee's findings of fact and the pattern for review of those findings is now firmly established in the Eighth Circuit by the cases just cited.

Under General Order in Bankruptcy No. 47 the District Court is required to accept a referee's findings of fact unless it determines that such findings are clearly erroneous.

And the Court of Appeals, by virtue of Rule 52 (a), is enjoined from setting aside the referee's findings of fact unless it finds that such findings are clearly erroneous. It is obvious that a referee's findings of fact, both ultimate and subsidiary, are the very foundation upon which the proper administration of the Bankruptcy Act rests and that anything short of full and careful compliance with the rules may not be justly countenanced.

The rationale of *In re Peoria Braumeister Co.*, 7 Cir. 1943, 138 F. 2d 520, illustrates the reason why a referee's duty to make findings of fact is not discharged by an attempt to include findings of fact in the certificate required by Section 39 (a) (8) of the Bankruptcy Act (11 U.S.C.A., § 67 (a) (8)).

In that case the referee did make some findings of fact and stated certain conclusions of law in support of his order disallowing a secured claim. A petition for review was promptly filed. The referee, some five months later, attempted to make additional findings of fact by including them in his certificate on the petition for review. In the District Court the petitioner for review unsuccessfully moved to strike the additional findings made in the referee's certificate and appealed.

The Court of Appeals held that the motion to strike should have been granted because "it was improper for the referee to make additional findings of fact in his certificate after the petition for review had been filed" (138 F. 2d at 522). In explanation of its holding, that court stated:

> Neither § 39, sub. a(8) of the Bankruptcy Act, 11 U.S.C.A. § 67, sub. a(8), nor § 39, sub. c, 11 U.S.C.A. § 67, sub. c, . . . contemplates that a referee may make additional findings of fact some five months after a

petition for review has been filed. Instead, § 39, sub. c, requires that the petition for review set forth the alleged errors committed by the referee. This is obviously impossible if the referee is allowed to make additional findings after the petition is filed (138 F. 2d at 522).

For the reasons stated we find that the Referee was not authorized by law to make any findings of fact in his certificate and therefore we refuse to review the findings of fact made in the certificate filed by the Referee in connection with Commercial Credit Corporation's petition for review. We expressly refuse to follow what is apparently the rule of decision of the Sixth Circuit as stated in *In re D.I.A. Sales Corporation* and apparently applied in *In re Berman & Company* because we are of the opinion that such a rule ignores the controlling force of General Orders in Bankruptcy Nos. 47 and 37, and Rule 52 (a) of the Rules of Civil Procedure.

Therefore, and pursuant to General Order No. 47, we recommit the matters involved in Commercial Credit Corporation's petition for review to the Referee for further proceedings consistent with this memorandum and order and the instructions we now state.

The Referee is instructed to "find the facts specially and [to] state separately its conclusions of law thereon and [to] direct the entry of the appropriate judgment" in connection with the orders which were the subject of Commercial Credit Corporation's petition for review, all in compliance with Rule 52 (a) of the Rules of Civil Procedure.

The Referee is instructed to conduct appropriate proceedings in order that the record be clear in regard to the evidence adduced at the June 8, 1964 hearing and in regard to the depositions taken in Cases No. 12427-1 and 12439-1 that pended earlier in this Court.

We have read the exhibits and the depositions that are apparently a part of the record, and without expressing any opinion in regard to the testimony contained therein, we do indicate that it is our judgment that a great deal of relevant evidence is contained in those exhibits and depositions to which no reference has been made either by the Referee or the parties.

As we have indicated above, we believe the Referee is required not only to make ultimate findings of fact but that he is also required to make sufficient subsidiary findings so that the theory and rationale upon which the Referee's orders are based is made apparent. He is instructed to do so.

The Referee is further instructed that his conclusions of law shall not only be stated separately but that they shall also be stated in sufficient detail for the reviewing courts to fully understand exactly what case authority and sections of the Bankruptcy Act are involved and relied upon and to understand the rationale of the Referee's application of the law to the facts as he shall find them.

The Referee is to understand, of course, that he may, in accordance with Rule 52 (a), file an opinion or a memorandum of decision and that such shall be considered to be sufficient if the requisite findings of fact and conclusions of law appear therein.

The Referee is also to understand that nothing we have said is to be taken to prevent him from requiring counsel to prepare and submit to him suggested findings of fact and suggested conclusions of law, supported by specific references to the record and by citation of appropriate legal authority to aid him in the discharge of his duty. See discussion of Findings of Fact, Conclusions of Law and Judgment, Seminar on Practice and Procedure,

28 F.R.D. at 268-282. See also Carter and Wagner: Findings of Fact, II Modern Practice Commentator 109 (August 1964), particularly at 122, where bankruptcy proceedings are discussed.

Indeed, the Referee may find it desirable to require counsel to file additional briefs on specific points not heretofore briefed either before him or this court. The impact, if any of the case of *Commercial Credit Corporation* v. *Blau,* (Mo. Sup. Ct. 1965) 393 S.W. 2d 558, is an example of such a specific point. Our instructions are not intended to prohibit such action.

Consideration of that case may, we do not rule that it does, require the detailed analysis of additional portions of the record not heretofore analyzed by either party. And it may even require the taking of additional testimony. What we have said here is not to be considered as any limitation upon the Referee to so proceed should he believe it necessary to do so.

In fact, if we were the Referee in this case, upon receiving the case back on remand, we would order a pretrial conference pursuant to Rule 16 of the Rules of Civil Procedure, in order to simplify and identify the real issues, both factual and legal. We would also probably require that the parties stipulate many of the ultimate facts about which there is obviously no dispute. Those matters, of course, are matters for the Referee to determine. We mention them only to make clear that our recommitment instructions do not prohibit such procedure.

For the reasons stated, and pursuant to General Order in Bankruptcy No. 47, the matters involved in Commercial Credit Corporation's petition for review should be and are hereby ordered recommitted to the Referee with instruc-

tions that he proceed further in accordance with the instructions stated herein.

The Clerk shall enter a separate judgment in accordance with Rule 58 of the Rules of Civil Procedure.

/s/ John W. Oliver
District Judge

Kansas City, Missouri
January 4, 1966

III

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI, WESTERN DIVISION

IN THE MATTER OF ROBY C. WOODY, d/b/a WOODY MOTOR COMPANY, Bankrupt. } **In Bankruptcy No. 23807**

(Referee's) Order on Trustee's Objections to Allowance of Claim of Farmers Bank and on Petition for Order to Show Cause Directed to Said Bank.

(Filed June 10, 1964)

The Trustee's Objection To Allowance Of the Claim Of Farmers Bank of Clinton, his Petition For Order To Show Cause directed to said bank, the Order To Show Cause made pursuant thereto, and said bank's Answer to such Order, came on for hearing on March 30, 1964; Vance Julian, Trustee herein, appearing in person and by his attorney, Phineas Rosenberg, and Farmers Bank of Clinton (herein called claimant), appearing by Harry F.

Finks, its president and by John G. Killiger and Julius Wall, its attorneys, and the aforesaid proceedings having been submitted on stipulated facts and oral testimony, and the Court having duly considered the submission made and being fully advised, does hereby find:

1. That the six month $16,000.00 loan dated November 22, 1957, made by claimant to bankrupt was evidenced by an instrument designated Note and Chattel Mortgage in which the security is described as: "All machinery and shop equipment, Oldsmobile special tools, Cadillac special tools, furniture, fixtures and parts bins" and the following moving stock of merchandise is described as: "parts, accessories, oil and grease, and paint"; that the installments due on said six months note and the payments as made thereon are as follows:

Due Dec. 22, 1957	$ 1000.00	paid	Dec. 24, 1957	$1000.00
Due Jan. 22, 1958	1000.00	paid	Jan. 21, 1958	1000.00
Due Feb. 22, 1958	1000.00	paid	Feb. 24, 1958	1000.00
Due Mar. 22, 1958	1000.00	paid	Mar. 24, 1958	1000.00
Due Apr. 22, 1958	1000.00	paid	Apr. 25, 1958	1000.00
Due May 22, 1958	11000.00	paid	May 22, 1958	1000.00
			June 23, 1958	1000.00
			July 25, 1958	1000.00
			Aug. 27, 1958	1000.00;

that on August 27, 1958, the unpaid balance on said note was $7,000.00; that claimant therafter allowed the principal payments due on said note to remain past due and in default, but collected interest thereon monthly until April 30 and May 7, 1959, when bankrupt made two $500.00 payments and reduced said indebtedness to $6,000.00;

2. That in May and June, 1959 (almost two years later) claimant made two loans to bankrupt; the first for $12,000.00 due in one week; the second for $16,000.00 due on demand; both loans were evidenced by notes secured

by *unrecorded* chattel mortgages which made no reference to the prior existing November 1957 mortgage and included no property described in said prior mortgage; that $3000.00 of the June 1959 loan was used to pay the unpaid balance due on the antecedent May 1959 loan, and the remaining $13,000.00 was deposited in bankrupt's bank account; that the security described in the May and June 1959 mortgages consisted of listings of used cars with no detailed identification of such cars which mortgages were delivered to claimant *without* certificates of title to said cars; that under said May and June 1959 loans and mortgages, claimant was and is a general unsecured creditor;

3. That said May and June, 1959, loans were temporary financing by claimant until bankrupt could obtain a long term capital loan from Commercial Credit Corporation or some other source; that claimant was informed of and knew bankrupt's financial condition and that bankrupt needed the long term capital loan; that at a meeting held on June 30, 1959, Commercial Credit Corporation's representative informed bankrupt and claimant that his company would not make such a loan until an audit was made of bankrupt's business and bankrupt had complied with other requirements for a capital loan; that thereupon claimant seized bankrupt's bank account in the sum of $9733.88 and credited that amount as a payment on the aforementioned June 1959 loan; that from all the evidence presented, the uniformity of action between claimant and the First National Bank of Clinton (another claimant herein) acting together and in unison and jointly with bankrupt and his active and extensive co-operation with both of said banks as stated herein, infra, the court finds a collusive pre-arranged and planned formula of action existed between them prior to bankruptcy with respect to the concurrent seizure of bankrupt's bank accounts in such

banks, with respect to bankrupt's transfer of free and clear assets to each of said banks without consideration on the eve of bankruptcy (to help such banks as he testified) and with respect to bankrupt's permitting such banks to jointly enter his place of business together on the same night and to remove therefrom the free and clear assets almost immediately after receipt from bankrupt of the chattel mortgages covering the property which each removed, also as stated herein, infra;

4. That on June 27, 1959, bankrupt's bank balance in claimant bank was $34.84; that in the next three days bankrupt made the following deposits in claimant bank to wit:

June 29, 1959 (one day prior to said seizure)	$10,581.15
June 29, 1659 (one day prior to said seizure)	762.15
June 30, 1959 (the day of the seizure)	480.04;

that by June 30, 1959 (in said three days), bankrupt had built up his bank balance in claimant bank under prearrangement to $11,197.14 from which claimant paid checks totalling $1463.26 and then seized the balance of $9733.88 as a set-off against its unsecured debt (June 1959 loan) leaving the unpaid balance due thereon of $6266.12;

5. That on July 1, 1959, the next day after claimant had seized his bank account as aforesaid bankrupt notified claimant that Commercial Credit Corporation was going to close his business, and to help the bank (as he testified) without receiving any money or other consideration therefor, bankrupt voluntarily gave claimant a new note and chattel mortgage for $6266.12, due on demand, covering the aforesaid unpaid balance due on the unsecured June 1959 loan, the security described in said July 1, 1959 mortgage was 16 free and clear used cars which bankrupt specifically and carefully identified in all necessary details by year, number, make, style and model and with the de-

livery of said mortgage to claimant he also delivered to it the certificate of title to said cars; that said voluntary July 1, 1959 mortgage so given to claimant refers to the prior existing June 1959 unrecorded mortgage but does not refer to the prior existing November 1957 recorded mortgage and does not describe any property described in said prior November 1957 mortgage;

6. That said voluntary July 1, 1959 mortgage was filed for record on July 2, 1959 (the next day) and on July 4, 1959, the following Saturday—a national holiday—or on July 5, 1959, the following Sunday, bankrupt permitted claimant and said First National Bank to enter his place of business jointly between the hours of 6:00 p. m. and midnight and remove 15 of said cars therefrom at night and under the cover of darkness, which cars claimant sold on July 11, 1959 (two days prior to bankruptcy), for $4500.00, and credited that amount as a payment on said July 1, 1959 note; that bankrupt paid said voluntary July 1, 1959 note in full by the following other payments, to-wit:

July 10, 1959 (3 days *prior* to bankruptcy)	$550.00
July 14, 1959 (1 day *after* bankruptcy)	866.12
July 14, 1959 (1 day *after* bankruptcy)	350.00;

7. That on July 1, 1959, also bankrupt gave Commercial Credit Corporation a demand note for $42,447.78 to cover his shortage to that company and secured that note with a chattel mortgage describing the same property as is described in claimant's prior existing November 1957 mortgage; that said July 1, 1959, mortgage to Commercial Credit Corporation provided that it was "subject to first chattel mortgage of record to Farmers Bank of Clinton" (claimant here) and was filed for record on July 2, 1959; that on the following July 8, 1959, Commercial Credit Corporation, acting under this July 1, 1959, mortgage, by writ

of replevin issued by the United States District Court for the Western District of Missouri, replevined said property from bankrupt which was subject to claimant's prior existing November 1957 mortgage and also replevined 38 automobiles covered by other mortgages and removed all of the aforementioned property from bankrupt's place of business;

8. That bankrupt was insolvent as of December 31, 1957, by $37,990.10, as of December 31, 1958 by $126,933.73 and as of May 31, 1959 (approximately 6 weeks prior to bankruptcy) by $149,072.73;

9. That concurrently with the foregoing transactions with claimant, bankrupt also arranged exact and similar transactions with the First National Bank of Clinton (another claimant) whereby it also was to, and did, seize bankrupt's bank account and also was to, and did, receive notes and chattel mortgages from bankrupt without money or other consideration for an antecedent debt; that claimant and said First National Bank of Clinton co-operated and acted together jointly and in unison with each other and with the bankrupt in seizing bankrupt's bank balances, in going into bankrupt's place of business together during the night of July 4 or July 5, 1959, and in removing therefrom the cars covered by their respective mortgages, which each had received as aforesaid;

10. That with respect to the property described in the November 1957 mortgage and in the May and June 1959 unrecorded mortgages, bankrupt at all times had possession thereof and unrestricted and unlimited power to sell such property and keep the money received from the sale thereof without claimant's control or supervision and at all times retained and kept possession of such property, including all automobiles and the certificates of title thereto for the purpose of sale;

11. That the November 1957 mortgage contained a default clause which empowered claimant to take possession of the property described therein, with or without legal process, and to sell the same at public or private sale, with or without notice, in Henry County, Missouri, or, at its option, in any county where said property may be found:

(a) If default be made in the payment of any installment of the note or any part thereof or the interest thereon, when due; *or*

(b) If bankrupt, or any person in his behalf, shall sell or attempt to sell, encumber, or remove said mortgaged property or any part thereof from Henry County, Missouri, without claimant's written consent; *or*

(c) If the personal property described in said mortgage or any part thereof shall be seized on legal process; *or*

(d) If claimant shall for any reason deem itself insecure;

12. That each of the default events listed in the default clause had occurred and existed at the time of bankruptcy; that for a period approximating two years prior to bankruptcy and despite such defaults and prior rights, claimant made no effort to act promptly (under the powers granted to it in said default clause) to foreclose its lien or exhaust its rights or otherwise protect itself with respect to the property described in its said November 1957 prior and recorded mortgage; that claimant was passive as to its claim thereunder and permitted the same to lie dormant for said two year period and did nothing as to bankrupt's breaches and defaults of said prior mortgage, as to bankrupt's debt to claimant, or as to its enforcement rights under said mortgage except to file a claim in this proceeding after

bankruptcy; that by allowing its claim to lie dormant, as stated, and by its passive and "do nothing" policy during said two year period with respect to bankrupt's defaults of said prior and past due mortgage, as stated, and by claimant's unexplained action in not referring to the long past due and prior November 1957 mortgage as continuing security in claimant's later May, June and July 1959 mortgages, claimant obscured and veiled its priority rights to the detriment of the rights of general creditors of this estate and by reason thereof claimant's said claim became and is inferior and subordinate to the rights of such general creditors;

13. That under the evidence and the foregoing findings claimant received void, voidable and fraudulent preferences, liens, conveyances, transfers, assignments and encumbrances from the bankrupt totalling $25,000.00 as hereinafter set forth for antecedent debts, within four months prior to bankruptcy, with knowledge of bankrupt's insolvency or with reasonable grounds to believe that bankrupt was insolvent, knowing that it was being or would be preferred thereby, to-wit:

(a) The $12,000.00 May, 1959, loan held by claimant as a general unsecured creditor on which bankrupt paid claimant the sum of $9000.00;

(b) The $16,000.00 June, 1959, loan held by claimant as a general creditor which bankrupt paid to claimant in full by the transfer of money and property as aforesaid, the sum of $16,000.00—total $25,000.00; that after consideration of all the evidence presented and upon the aforesaid findings, it is hereby

Ordered and Adjudged:

That Farmers Bank of Clinton be and it is hereby ordered and directed to turn-over, surrender and pay to Vance Julian, Trustee herein, the sum of $25,000.00;

That upon complying with said order pursuant to Section 57 of the Bankruptcy Act (11 U.S.C.A., Sec. 93), the claim of said Farmers Bank of Clinton be and the same is hereby allowed, subject, subordinated and inferior to the rights of general creditors of this estate; and

That if said Farmers Bank of Clinton does not comply with the aforesaid order to pay said $25,000.00, then the claim of said Farmers Bank of Clinton be and the same is hereby disallowed.

Made at Kansas City, this 10 day of June, 1964.

Harry F. Murphy
Referee in Bankruptcy.